

BALANCING SOVIET RESOURCES IN 1986-90: CORBACHEV'S DILEMMA

An Intelligence Assessment

(Information as of 31 May 1985 was used in this report)

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Key Judgments

General Secretary Gorbachev must decide how to address the conflicting demands of the major resource claimants during the next five-year plan period (1986-90). This will be a far more difficult balancing act than before because:

- The leadership is likely being pressured to increase allocations to all three resource claimants--defense, investment and consumption--unlike recent plan periods when it seemed that the demands of one or another claimant could be safely deferred.
- Soviet economic growth probably will continue its downward trend through the end of the decade--at a rate of 1.5-2.5 percent per year. [REDACTED]

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If Gorbachev believes that the rebound in growth that occurred in 1983-84 can be sustained--by good weather and his current emphasis on new personnel, measures to tighten discipline and modest economic reforms--the resource dilemma might not appear so urgent. Specifically, an annual growth rate of about 4 percent would allow for a balanced approach to resource allocation during 1986-90--in essence a continuation of the strategy followed during the current five-year plan period. [REDACTED]

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If Gorbachev's initiatives cannot spur the requisite growth, pressures will increase to change these priorities. By the time the failure to accelerate growth becomes apparent--probably a

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[redacted]

year or so into the 12th five-year plan--Gorbachev will have had a greater opportunity to develop his economic strategy and fully consolidate his political position. He may still decide that conservative economic policies and a balanced resource approach are his best options, particularly if, like some Soviet economists, he sees the next decade as a time when some of the resource constraints such as labor shortages will be relieved.

[redacted]

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On the other hand, Gorbachev--who can look forward to a long tenure--may be ready to take a gamble that the economic benefits flowing from a more radical approach will outweigh the potential political risks. This might entail a bolder approach to economic reform--such as a program equal in size and stature to the Kosygin reforms of 1965 or a major expansion of the private sector--which would be a good litmus test of the leadership's commitment to change.

[redacted]

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In the resource allocation area, Gorbachev may decide to risk the political fallout associated with giving a clear priority to one of the major claimants. The choice of which claimant to favor would depend on a variety of domestic and external catalysts, such as the state of US-Soviet relations, the success of efforts to narrow the technology gap with the West, and the apparent link between consumer frustrations and the failure to raise productivity growth.

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We should see some leading indicators of such a shift in resource allocation policy:

- A substantial boost in military expenditures might be indicated by an accelerated deployment of major weapons programs or the replacement of Minister of Defense Sokolov with a more aggressive military figure.
- A shift to investment might be indicated by a major boost in orders for Western equipment and technology and major new investment programs in sectors other than food, energy and machinebuilding.
- The consumer might be favored if we see the elevation of strong consumer advocates to the Politburo such as party secretary Kapitonov or the promulgation of an impressive consumer goods program backed by a real resource commitment. [REDACTED]

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Regardless of which option is chosen, Gorbachev and his new team will have a full plate coping with the consequences of continued slow growth and mounting resource demands. This nexus of problems and the solutions chosen will have a direct impact on Soviet policy with the United States and its allies. Some would raise the degree of confrontation while others might spur a more accommodating posture. [REDACTED]

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Preface

This paper looks at resource allocation issues over the next five years from the leadership's perspective. It examines the pressures that are being exerted upon them to choose among the resource claimants. These pressures are both economic--the needs to modernize the aging capital stock and to house and feed the population--and political--the need to juggle the support of powerful vested interests and maintain legitimacy in the eyes of the general public. The pressures are not only domestic but external--the US military buildup and the state of East-West trade relations, for example. [REDACTED]

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A further complicating factor is that these decisions are being made by a leadership in transition. The way that the new Gorbachev team handles these problems may give us clues to their actions in other policy areas. There are pressures on them to act quickly and decisively but also good reasons for them not to. There are a bewildering array of options open to them. The paper attempts to narrow these choices, as they must do, and present the most likely alternatives. Because the leadership's strategy is not easily discernible, we present some advance indicators of a shift in course. [REDACTED]

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Introduction

Work was almost complete on the 1986-90 plan when Chernenko died, and it is unlikely that Gorbachev will disrupt its progress. As Second Secretary with increasing responsibilities as Chernenko's health deteriorated, he probably had a good opportunity to influence the plan's priorities. The economy in general was apparently one of his responsibilities, and agriculture had been his portfolio on the Secretariat since 1978. [REDACTED]

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Gorbachev, moreover, may not feel it necessary to take initiatives at this point, opting instead to take advantage of the five-year plan's natural evolution. A five-year plan is just a general statement of intentions and not a rigorous timetable, although the five-year defense plan may be less susceptible to change. As conditions change and/or planning mistakes occur, the annual plans traditionally are amended accordingly. In addition, as Gorbachev rejuvenates the ranks of economic administrators and formulates his own economic strategy, he can begin to influence and shade the multitude of economic decisions that constitute the annual plan and which may eventually result in a perceptible shift in priorities. [REDACTED]

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Current Economic Policy

During 1981-85, the Soviets had to cope with mounting resource demands and slowing growth. They initially chose a strategy that allowed for only modest growth in investment and small increases in consumer welfare but subsequently decided to boost the rate of investment growth. The slower growth in defense begun in the previous planning period continued at least into the first two years of the 1981-85 plan, and there is continued uncertainty as to its motive. [REDACTED]

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Defense - The Soviets have never published comprehensive projections of defense spending. We estimate that at least in 1981-82, the growth of defense outlays held to about 2 percent, as it had since 1976. Because this rate paralleled the downturn in economic growth, the share of GNP devoted to defense during the past decade remained stable at 13-14 percent, nearly twice the US share. The slowdown in the growth of defense spending was due largely to zero growth in military procurement. [REDACTED]

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Preliminary evidence for 1983 shows an upturn in procurement, but it is too early to tell if this is an indicator of a resumption in more rapid growth of defense expenditures. A 12 percent increase in the official defense budget for 1985 was announced at the November Supreme Soviet session. This announcement could be just a political gesture to indicate that Moscow intends to maintain a strong defense posture, but it could

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also be indicative of a real increase in defense expenditures.

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Investment - The Soviets planned to hold down investment growth during 1981-85 and rely more on productivity growth, as they had in 1976-80. However, the rate of growth in industrial production fell at an alarming rate, and capital costs rose even faster than before--largely because of unforeseen costs in bringing new capacity into production and mistakes in allocating investment. The Soviets apparently abandoned this low investment policy early in the plan period. Investment growth during 1981-85 probably will be about double the planned rate although rates of growth in individual years have been uneven.

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Within the investment sector, major programs such as energy and agriculture and those sectors that are critical to enhanced productivity gains such as machine building apparently are receiving the lion's share of investment resources during 1981-83. According to Gosplan chief Baybakov, three sectors will enjoy "preferential" rates of investment growth in 1985--energy, raw materials, and machinebuilding.

Consumption - Indicators used to judge planned growth in consumer welfare suggested that overall gains would be small during 1981-85. Specifically, the Soviets planned to hold down the growth in wages and transfer payments to the lowest rate in at least 20 years, a move that would have been inconsistent with

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planning a large increase in the availability of goods and services. [ ]

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The regime apparently decided to focus its limited resources for the consumer on those areas--food and housing-- that were most vital to maintaining the consumer's sense of well-being. Evidence of the leadership's commitment to improving food consumption was the launching of the Food Program in 1982-- designed to increase incentives, reduce waste and redistribute investment--and the continued purchase of large quantities of foreign grain and meat. During 1981-85, Moscow will probably spend over \$50 billion on imports of farm products, or about 40 percent of its total hard currency import bill. Housing has received increased priority in this planning period; during 1981-84 commissionings of new housing averaged 110 million square meters compared with 107 million in 1976-80. The regime also initiated improvements in the consumer area that did not require an expenditure of resources. An economic experiment begun in the consumer services area in July 1984, for example, was designed to improve management and worker incentives in this long-neglected consumer area. [ ]

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Actual consumption growth during 1981-85 probably will be even lower than the Soviets anticipated. Largely as a result of poor harvests, per capita consumption actually dropped in 1982 and increased by only about 1.5 percent in 1983. Farm output

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nearly stagnated in the late 1970s and early 1980s, partly because weather conditions were much less favorable than in 1964-74. The slow growth in per capita consumption may also be related to a reduced priority in allocating new investment funds to consumer-related areas in the previous planning period. During 1976-80, investment in agriculture, light industry, processed foods, and housing took only 30 percent of the increase in total investment compared with 41 percent during 1966-70 and 1971-75. \_\_\_\_\_

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### The 12th Five-Year Plan Dilemma

#### Competing Demands

The competition for resources among the major claimants during 1986-90 will be far greater than it was in 1981-85. Then the leadership went into the planning period believing that productivity growth could compensate for lower rates of investment growth and was willing to tolerate low growth rates for defense spending. Now the leadership is under pressure to allocate substantial increases to all major resource claimants:

- The Soviet military must be arguing for a boost in allocations given the past slowdown in procurement, the number of projects entering the production stage and the US military build-up.

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-- Increased investment is needed to replace the antiquated capital stock and also to keep pace with the ambitious investment programs already adopted for food and energy.

-- Consumer demands must continue to be satisfied in order to boost productivity growth and, in the eyes of some observers, to prevent civil discontent. [REDACTED]

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#### Defense

Plans for force modernization and the fact that major weapons systems are coming to the end of their development cycle argue for boosting defense over the coming years. We estimate that a substantial number of new or modified systems will reach initial operational capability during the 1980s--substantially more than either of the two previous decades. [REDACTED]

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[REDACTED] during 1986-90 the Soviets will

attempt to:

-- Achieve a major modernization of their strategic defensive forces, [REDACTED]

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-- Continue the broad modernization of their strategic offensive forces with major production programs for each of the primary strategic force elements. [REDACTED]

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- Increase greatly their power projection capability, including their first-ever Western-style aircraft carrier and a new heavy transport aircraft.
- Push the rapid expansion of their military space effort.
- Sustain the modernization programs for conventional and theatre nuclear forces, especially those deployed opposite NATO. [REDACTED]

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Pressure to compete with the US Strategic Defense Initiative (SDI) will also add to defense requirements and make it more difficult for the Soviets to plan for long-run military needs. Soviet scientists have stated that a workable US SDI system will not be possible for at least a decade and that the cost of countering it will be far less than building one, but their statements suggest a fear that a technological breakthrough resulting from SDI-related research, such as in lasers, could have a more immediate payoff in other weapon systems. [REDACTED]

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Soviet leaders from Brezhnev through Chernenko have had to deal with critics who argued that the military was not receiving adequate resources to counter the perceived US threat. The October 1982 speech by Brezhnev to the military leadership was a clear attempt to calm disgruntled elements there. While he tossed them a sop by endorsing the military's need to stay

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competitive in R&D and by omitting mention of START of I&F talks, he took the position that the Party "adopts measures to meet all your needs," a view that was generally endorsed by Defense Minister Ustinov. [redacted]

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Chernenko stated soon after becoming General Secretary that the allocation of "considerable resources" to defense "over the past five years" had not been allowed to cut into "social programs." A subsequent reformulation of this pronouncement in July and September 1984 seemed designed to establish that this was not just an historical statement but current policy. [redacted]

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the defense sector has been forced to share its priority claim to resources with some consumer-related sectors, especially the Food Program. In April 1984, Chernenko [redacted]

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[redacted] did not believe it necessary to extend the work week or establish a defense fund in order to preserve the country's security. On other occasions, however, he raised the spectre of nuclear war precipitated by Pershing deployments and growth in US military budgets. [redacted]

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One group arguing for increased resources for defense apparently is a military contingent which disagrees with Brezhnev that "all the needs" of defense are being met. Marshal Nikolay Ogarkov, former Chief of the General Staff, has been a vigorous spokesman for military interests and may belong to this group.

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[redacted]

During the last several years Ogarkov has repeatedly emphasized the need to compete with the US defense effort, on which, he asserts, the Reagan administration has lavished "incredible sums." His assertiveness on this issue may have played a role in his demotion last September. [redacted]

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Some members of the Politburo may also feel that it is time for a boost in defense spending. In their Supreme Soviet election speeches early in 1984, most of the leadership described the strengthening of defense as a longstanding concern, but one not requiring a diversion of resources. Two leaders, however-- Party Secretary Romanov, responsible for the defense industries, and Ukrainian party chief Shcherbitsky--took a somewhat different tack. Romanov said that the party and state "will equip" the Army and Navy with everything necessary--a nuance at variance with the prevailing line that the armed forces already had everything they needed. Shcherbitskiy said that the Soviets will return to detente "only when the defense might of the Soviet Union and our allies is sufficient...", a statement that might also be interpreted as a call for increased resources. In late 1984, he announced the appointment of a new republic Central Committee Secretary to supervise the defense and high technology industries, the only republic leader to do so. [redacted]

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Thus far, Gorbachev's public position on this issue has not been established. While citing the need "more than ever to be on

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guard, to display high vigilance, and to strengthen our defense in the face of Imperialism's mounting aggressiveness," he has often balanced such assertions with more conciliatory rhetoric. In his February 1985 election speech he merely assured his audience that defense was being maintained "at the proper level." [REDACTED]

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#### Investment

If the Soviets continue to have problems in raising productivity growth, as they have in the past, then a boost in investment growth\* during 1986-90 is required to:

- support major new programs for food and energy;
- expand the machinebuilding and metalworking sector--the key to future production of investment goods, military hardware, and consumer durables;
- relieve bottleneck sectors such as transportation;
- modernize sectors vital for productivity growth such as ferrous and non-ferrous metallurgy. [REDACTED]

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The Food Program, introduced in May 1982, has been given high priority by successive regimes as the key to reducing dependence on foreign imports of grain and foodstuffs. This program laid early claim to about one-third of total investment during 1986-90, the same share that was allocated in the current

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five-year period. According to Soviet data released in conjunction with the approval of the Long-Term Energy Program, investment in the energy complex during the 12th Five-Year Plan will take 22 percent of total investment compared with about 17 percent during 1981-85. Moreover, this share might be further increased since Soviet planners may be in the process of raising their estimates of investment requirements in energy. Soviet oil production in 1984 was 3 million tons less than in 1983, and Soviet press reports indicate that the amount of drilling required to achieve the 1984 output was well in excess of plan--suggesting that investment requirements in this sector were underestimated. [redacted]

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If the momentum of the Food and Energy Programs is maintained--as leadership statements suggest--allocations to the remaining sectors will be squeezed severely; if total investment increases by only 2 percent, for example, investment in these sectors must remain flat. This squeeze comes at a time when there is a critical need to increase investment in machinebuilding and metalworking in order to raise its technological level. [redacted] 30-40 percent of all equipment has been in operation for more than 15-20 years, while capital repair in industry is equivalent to at least one-third of total investment in new fixed capital. [redacted]

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A substantial backlog of necessary investment exists in

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other areas as well. The transportation sector, especially the railroads, remains a potentially serious bottleneck. Officials from the Central Asian republics have lobbied heavily for costly irrigation projects. Such industrial branches as ferrous and non-ferrous metallurgy and chemicals require more investment funds if they hope to raise productivity. Investment funds are also needed for long-neglected consumer areas such as light industry. The squeeze is already evident here. [redacted]

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[redacted] the most serious problem has been the scarcity of investment funds for light industry. [redacted]

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In contrast with previous plan periods, the leadership has been silent concerning the future direction of investment growth. In 1979, for example, then Chairman of the Council of Ministers Kosygin noted that the low investment growth occurring during 1976-80 was a "positive trend...it must be enshrined in plans for the future." However, members of the current leadership have repeatedly called for an acceleration of scientific and technical progress, which has direct implications for investment growth. Gorbachev, in fact, has called for "revolutionary change" in this area and has noted that the problem is particularly acute because of the "considerable age" of the country's production apparatus. [redacted]

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Within the investment category, the leadership has

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apparently reached a consensus to continue supporting the investment demands of the Food and Energy Programs and to increase investment in MBMW. A summary of the proceedings of a July 1984 Central Committee conference on the five-year plan noted that the "faster growth" of machinebuilding was being given "great attention." Gorbachev, in major speeches both before and after becoming General Secretary, indicated that investment in MBMW must be given preferential treatment. He told the April party plenum that it is necessary "to speed up by one and a half to two times" the rates of growth in this sector during 1986-90. "[redacted]"

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#### Consumption

Continued growth in consumption is required during 1986-90 in order to stimulate the growth in labor productivity and to help prevent worker unrest. The most urgent demand continues to be an improved diet. The Food Program, particularly the emphasis on decreasing waste in procurement and processing, may yield some results during 1986-90, but it will not be a panacea.\* One of the Program's major features--the redirection of investment resources between the farm sector and its supporting industries--will not bring a quick pay-off and indeed is not occurring at planned rates. As a result, the Soviets will need to continue to

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allocate scarce foreign exchange for food imports for the foreseeable future. [redacted]

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A new consumer program for 1986-90, only parts of which have been unveiled, is to concentrate on improving the supply of non-food consumer goods. Although it will require some increase in resources, a Gosplan official indicated in a Soviet press article last July that the program's success would depend largely on better and more efficient planning and organization rather than a larger resource commitment. In a recent conversation with a US Embassy officer in Moscow, a Soviet economist working on the program revealed that the program has not succeeded in wresting the necessary resources to make it "impressive enough" to introduce. One problem is the reported unwillingness of certain CEMA countries to pledge increased exports of consumer goods to the USSR when they could be sold to the West for hard currency.

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The recent regimes have been careful not to raise the expectations of the consumer for 1986-90, although they have continued to cling to the rhetoric begun in the Brezhnev era that the major focus of the five-year plans is the consumer. Even Chernenko, who was generally regarded as the leading consumer advocate under Brezhnev, toned down his rhetoric on this issue when he became General Secretary. He reminded workers that if they wanted to live better, they had to work better, and he held

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out the prospect of improving only selective consumer areas that would have the greatest impact on worker morale--food and personal and communal services (particularly housing and medical services). Chernenko believed, however, in zealously defending these favored sectors from encroachment by other claimants, exemplified by his statement about limiting the impact of defense spending on "social programs." [redacted]

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It is likely that Gorbachev shares Chernenko's sentiments about the importance of selected consumer areas, particularly food, since he has been the leadership's agricultural spokesman since 1978. In his December ideology speech he also emphasized the need to improve the health care system, which "does not fully meet present needs." However, since becoming General Secretary, Gorbachev's messages to the consumer generally have been less reassuring than those of his predecessor. He has been a firm advocate of "social justice," which includes the policy of tying wage increases closer to productivity growth. He has also picked up on Andropov's discipline campaign which had flagged under Chernenko. [redacted] greater

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"order" and discipline" would be required to "squeeze more out of the economy." Moreover, in this same forum, he warned that consumer sacrifices might be necessary if national income growth does not reach 4 percent per year during 1986-90. [redacted]

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Growth Prospects and Resource Trade-Offs

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Despite some improvement in the economy's performance during 1983-84, Soviet economic growth is likely to continue its long-term downward trend (see Figure 1). We estimate that Soviet GNP growth will range between 1.5 and 2.5 percent annually during 1986-90 because of the regime's continued inability to generate resource inputs at past rates and to stem falling productivity. This reflects mainly:

- smaller additions to the working-age population during the next several years than at any time since the early 1960s.
- rising costs of extracting and transporting industrial raw materials.
- a continued slowdown in the growth of capital stock.
- only marginal improvements in growth from Gorbachev's campaign to reinvigorate management and increase worker discipline.

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The Soviets can do little to ameliorate the first two problems during the remainder of the 1980s. Labor force participation rates for both men and women in the primary working ages (20-59) are already over 90 percent--higher than in any country in the world--and the majority of the pension-age population have jobs. Also, production costs will continue to rise rapidly over the next five years, particularly in the extractive industries, as a result of the declining quality and

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quantity of easily accessible raw materials. A leadership decision to boost investment would have some impact on GNP growth during 1986-90 but its principal effects would fall in the 1990s. New fixed investment is converted into capital stock with a substantial lag, and the existing capital stock is so large that increments in investment would have to be very large to significantly boost its growth. [redacted]

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The Soviets sooner or later must face the fact that the growth in GNP during 1986-90 will not permit them simultaneously to give preference to investment growth, return to the defense spending rates of the early 1970s, and increase consumption substantially. A major commitment could be made in one of these areas, but this would probably require little or no gain in one or both of the others. If, on the other hand, defense, investment, and consumption are all allowed some growth, none will grow enough to meet the full range of challenges faced. [redacted]

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One example should suffice to illustrate the dilemma.\* If the Soviets were to accelerate defense spending to 4-5 percent while maintaining investment at 4 percent, a faltering in overall economic growth would cause living standards to stagnate or even decline. Looked at in another way, the decision to accelerate

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both investment growth and defense spending would cause the share of output from the machinebuilding sector going for consumer durables to decline rapidly and be cut by almost two-thirds by 1990. A sharp increase of machinery imports from the West and/or Eastern Europe would relieve pressure on the domestic machinebuilding sector but would force Moscow to cut back on its agricultural purchases or accept a large increase in its debt.

[redacted]

Addressing the Dilemma

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[redacted] An unusual absence of heated debate over the 1986-90 plan may indicate continued optimism over future economic performance and/or a deliberate decision to avoid potentially divisive issues at the leadership level. In any event, there is no need to define a strategy at this point; annual plans will be continually amended in response to changing economic conditions and leadership policies in addressing them. [redacted]

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Corbachev has publicly demonstrated his impatience with slowing economic growth and--by dismissing some senior officials and publicly stressing the urgency of economic change--has made it clear that he will take steps to improve economic performance.(see Box). How Corbachev ultimately responds to the resource dilemma will have implications for his strategy in other

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areas. Traditional Soviet conservatism and optimism argue strongly for a continued balancing act among resource claimants in the hope that future improvements in economic performance will allow some gains for everyone. This option will look less viable if economic growth continues its downward trend. A more radical approach may then be tried--giving clear priority to one of the

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BOX TEXT

## GORBACHEV'S EMERGING AGENDA

April speeches by General Secretary Corbachev and First Deputy Premier Aliyev outlined ambitious goals for revitalizing the Soviet economy and addressing social problems. Both leaders were implicitly critical of Chernenko's inaction. Corbachev identified accelerating economic growth as his primary domestic goal and claimed Politburo backing for a strategy that included more rapid introduction of new technology, a restructuring of investment, new initiatives in management and planning and stricter performance standards. [REDACTED]

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Both Corbachev and Aliyev appeared to pin particular hopes on the ability of their social program to spur managers and workers to operate at peak efficiency. Their social agenda includes a pledge to link material rewards more closely to performance, an offer of accelerated advancement to younger, better educated cadres and an attack on corruption and privilege. [REDACTED]

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BOX TEXT END

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claimants. If consumption or investment were chosen, this would hold some promise of breaking the low-productivity slow-growth logjam and ultimately narrowing the technological and consumer welfare gaps but would risk losing the crucial support of major interest groups. [REDACTED]

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#### The Balanced Option

The new leadership probably will steer away from major changes in economic policy while Corbachev is consolidating his political position and assessing the economy's growth prospects. Corbachev, despite his stated disappointment with this year's economic growth, may in fact believe that the economy's improved performance in 1983-84 can be sustained through the rest of the 1980s. In his view, a little luck with weather, some modest economic reforms, a rejuvenation of key economic personnel, and a reinvigorated discipline campaign might boost growth enough to substantially ameliorate the resource dilemma. In his May speech to party members in Leningrad, he indicated that the target for growth in national income for 1986-90 would be an ambitious 4 percent. If Corbachev chooses this option, we might expect to see:

- a balanced approach to resource allocation, that is, no clear priority for one claimant over the others.
- strong emphasis on worker discipline and continued modest experiments in economic reform,

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[redacted]

-- restrained interest in growth of East-West trade and continued reluctance to incur a substantial increase in their hard currency debt. [redacted]

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Such a policy, reinforced by shared high expectations of growth, would stand a good chance of being accepted by the major interest groups, at least in the short run. Although consumption's share is likely to decline, consumer advocates could take some satisfaction in the continued commitment to food imports, the Food Program, and improvements in selected areas such as housing and medical services. A higher investment target would be heartening to those who believe that this is necessary to lay a foundation for future gains in productivity. Military interests would be served by some rise in the growth rate of defense spending, which should allow for impressive force gains during the remainder of the decade. [redacted]

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#### A More Radical Option

However, if growth proves to be 1.5-2.5 percent per year during 1986-90, as we predict, then even the modest demands of the resource claimants cannot be satisfied. Pressures will increase to take more decisive action. Even with these pressures, Corbachev may still decide that conservative economic policies and a balanced approach to resource allocation are his best option. He may not feel confident enough to aspire to more than "muddling through." This option will continue to look

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attractive particularly if the leadership believes that the 1990s will reduce some of their economic constraints. Growth in the labor force, for example, will turn upward again in the next decade. [redacted]

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On the other hand, Gorbachev--who looks forward to a long tenure--may decide to exercise a more radical option. In so doing, he would have to weigh carefully the long-term economic benefits against the potential costs to his political power and prestige. Evidence of such a shift might be his general approach to the issue of economic reform--a good litmus test of any leader's commitment to change.\* A reform program equal in size and stature to the Kosygin reforms of 1965--intended to increase enterprise autonomy and improve incentives--or a major expansion of the private sector would be the type of reform needed to signal a distinct break with the policies of recent regimes. [redacted]

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In the resource allocation area, this willingness to take more provocative actions could result in a decision to grant a clear priority to one resource claimant rather than accept the predictable consequences--continued slow growth--of a balanced approach. If consumption or investment was given priority, the hope would be that this would stimulate growth enough to eventually satisfy the demands of all claimants. If defense was

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avored, the Soviets might hope that this would provide the necessary security in the short run, but in the longer-run, the increased investment and technology dedicated to defense could provide some support for the civilian sector as well. The one chosen for favored treatment would depend on a variety of domestic as well as external factors such as:

- A collapse of the strategic arms talks and/or breakthroughs in US research on SDI might favor a shift to the military.
- Continued difficulties in accelerating the pace of science and technology, even after launching a major new program in this area--scheduled for a June unveiling--might bolster the position of those who argue for increased investment growth. In this regard, the rumored addition of influential economists such as Abel Aganbegyan to Gorbachev's band of advisors is significant.
- A realization that the slow growth in consumption causes worker frustrations that will continue to work counter to measures to boost productivity growth and which cause an unacceptable ennui in every aspect of Soviet society might tip the scales toward the consumer. [redacted]

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We can expect to see some advance warning of such a shift in resource allocation policy. Indicators of a preferential growth

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rate for defense might be:

- Replacement of Minister of Defense Sokolov with a more aggressive advocate of an accelerated defense effort.
- A reversal of the policy [ ] to force the defense sector to share its priority claim to resources with some consumer-related sectors.
- Accelerated deployment of major weapons programs. [ ]

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Indicators of a preferential growth rate for investment might be:

- Major new investment programs in addition to those for food, energy and machinebuilding.
- Leadership statements that draw a direct link between their technology gap with the West and the slow rate of investment growth.
- A major boost in orders for Western equipment and technology and a willingness to increase the burden of the hard currency debt. [ ]

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Indicators of a preferential growth rate for consumption might be:

- Promotion to Politburo status of party secretary Kapitonov, now responsible for light industry and consumer goods.
- Promulgation of a consumer goods program that allocates additional resources to this sector rather than relying mainly on better planning and organization.

25X1

[REDACTED] 25X1

- Sizeable increases in wages, sustainable only by increases in the availability of goods and services. [REDACTED]

25X1

Regardless of which option is chosen, Corbachev and his new team will have a full plate coping with the consequences of continued slow growth and mounting resource demands. This nexus of problems and the solutions chosen will have a direct impact on Soviet policy with the United States and its allies. Some would raise the degree of confrontation while others might spur a more accommodating posture.

- A high investment strategy, for example, would motivate Moscow to increase imports from the West.
- A high defense strategy would increase tensions with the West but, ironically, would also require expansion of East-West trade to acquire high technology.
- A high consumption strategy might imply internationally a relatively more moderate policy and spur agreements on arms controls. [REDACTED]

25X1

[REDACTED] 25X1

[REDACTED] 25X1